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# REPORT OF THE WORKING GROUP ON INTERNATIONAL CONTRACT PRACTICES ON THE WORK OF ITS TWENTY-THIRD SESSION
(New York, 9 - 20 January 1995)

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## I. INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session, 1/ the Working Group on International Contract Practices devoted its twelfth session to a review of the draft Uniform Rules on Guarantees being prepared by the International Chamber of Commerce (ICC) and to an examination of the desirability and feasibility of any future work relating to greater uniformity at the statutory law level in respect of guarantees and stand-by letters of credit. The Working Group recommended that work be initiated on the preparation of a uniform law, whether in the form of a model law or of a convention.

2. That recommendation was accepted by the Commission at its twenty-second session. 2/ The Working Group devoted its thirteenth to twenty-second sessions to the preparation of a uniform law (for the reports of those sessions, see A/CN.9/330, 342, 345, 358, 361, 372, 374, 388, 391 and 405). That work has been carried out on the basis of background working papers prepared by the Secretariat on possible issues to be included in the uniform law. Those background papers included: A/CN.9/WG.II/WP.63 (tentative considerations on the preparation of a uniform law); WP.65 (substantive scope of application, party autonomy and its limits, rules of interpretation); WP.68 (amendment, transfer, expiry and obligations of the guarantor); and WP.70 and WP.71 (fraud and other objections to payment, injunctions and other court measures, conflict of laws and jurisdiction). The draft articles of the uniform law, which the Working Group decided should, as a working assumption, be in the form of a draft Convention, were submitted by the Secretariat in documents A/CN.9/WG.II/WP.67, WP.73 and Add.1, WP.76 and Add.1, WP.80 and WP.83. The Working Group also had before it a proposal by the United States of America relating to rules for stand-by letters of credit (A/CN.9/WG.II/WP.77).

3. The Working Group, which was composed of all States members of the Commission, held its twenty-third session in New York from 9 to 20 January 1995. The session was attended by representatives of the following States members of the Working Group: Austria, Bulgaria, Canada, Chile, China, Costa Rica, France, Germany, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Morocco, Nigeria, Poland, Republic of Korea, Russian Federation, Saudi Arabia, Slovak Republic, Spain, Sudan, Thailand, United Kingdom of Great Britain and Northern Ireland, United States of America and Uruguay.

4. The session was attended by observers from the following States: Algeria, Australia, Belize, Bosnia and Herzegovina, Cambodia, Colombia, Croatia, Czech Republic, Indonesia, Kuwait, Lebanon, Madagascar, Monaco, Romania, Swaziland, Sweden, Switzerland and Ukraine.

5. The session was attended by observers from the following international organizations: International Monetary Fund, Cairo Regional Center for International Commercial Arbitration, European Banking Federation, International Bar Association and International Chamber of Commerce.

6. The Working Group elected the following officers:

Chairman: Mr. Jacques GAUTHIER (Canada)

Rapporteur: Mrs. Valentina TSONEVA (Bulgaria).

7. The Working Group had before it the following documents:

(a) Provisional agenda (A/CN.9/WG.II/WP.84);

(b) Note by the Secretariat containing articles 1 to 27 of the draft Convention (A/CN.9/WG.II/WP.83);

(c) Report of the Working Group on International Contract Practices on the work of its twenty-second session (A/CN.9/405).

8. The Working Group adopted the following agenda:

1. Election of officers.

2. Adoption of the agenda.

3. Preparation of a draft Convention on independent guarantees and stand-by letters of credit.

4. Other business.

5. Adoption of the report.

## II. DELIBERATIONS AND DECISIONS

9. The Working Group discussed draft articles 7(2) to 16, 24, 25 and 25 bis as set forth in document A/CN.9/WG.II/WP.83, proposals made by the Secretariat on draft articles 24 bis and new article 25 bis, and draft articles 17 to 27 as set forth in the annex to document A/CN.9/405. The deliberations and conclusions of the Working Group relating to those draft articles of the draft Convention are set forth below in chapter III.

10. Following its approval of the substance of those articles, the Working Group referred the articles of the draft Convention it had discussed to a drafting group. The Working Group reviewed the articles after the review by the drafting group and approved the text of those articles as set forth in the annex to the present document, along with the articles that had been approved at the twenty-second session.

11. An observer of the International Chamber of Commerce (ICC) expressed the concern of ICC regarding the Working Group's decision to make available the draft Convention to cover commercial letters of credit, at the option of the parties. ICC expressed the view that the Convention had so far exclusively dealt with independent guarantees and stand-by letters of credit and that extending the scope at this late stage to cover commercial letters of credit, which in its opinion was done at the insistence of one delegation, was not advisable. In addition to these remarks, ICC also presented some comments on particular articles of the draft Convention.

12. In response, it was pointed out that the Working Group had considered the question of how to deal with commercial letters of credit in the draft Convention over a number of sessions. The

parties to commercial letters of credit to opt into the Convention, but, absent such an election by the parties, did not as such extend the Convention to cover commercial letters of credit. It was further pointed out that this was a decision of the Working Group by consensus and had not been urged on the Working Group by any one delegation. It was further noted that, during the course of the preparation of the draft Convention, the Working Group had always kept it prominently in mind that stand-by letters of credit would involve application of the Uniform Customs and Practice for Documentary Credits (UCP). For that reason, the Working Group had ensured that no provisions of the draft Convention were in conflict with the UCP.

13. Regrets were also expressed that the comments by ICC on specific articles had not been provided to the Working Group at earlier points, at which time the comments would have been more usefully considered. ICC, however, notified the Working Group of its intention to participate more actively in the future in the work of the Commission and regretted the misunderstanding as to how the Working Group had made the decision on how to deal with commercial letters of credit.

## III. CONSIDERATION OF ARTICLES OF DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT

### [CHAPTER III. EFFECTIVESS OF UNDERTAKING]

#### Article 7. Issuance, form and effectiveness of undertaking (continued)

Paragraph (2)

14. Views were exchanged as to the adequacy and clarity of the twin rule formulated in paragraph (2), which dealt both with the "effectiveness" of an undertaking as well as with its "irrevocability". Questions were raised as to the clarity of the notion of "effectiveness", since it might inspire questions of a doctrinal nature on which legal systems might differ, such as whether the undertaking was of a contractual or non-contractual nature. A question was also raised as to the other aspect of paragraph (2), namely, the rule on irrevocability taking hold upon issuance. It was suggested that the rule bestowing irrevocability at the point of issuance might be referring to a premature point of time, since there could be cases in which the guarantor/issuer would wish to alter an undertaking prior to the beneficiary accepting it or perhaps even becoming aware of the undertaking. The view was expressed that the matter could be clarified by making the effectiveness of the undertaking clearly subject to acceptance by the beneficiary.

15. After considering questions of the type described above, the Working Group affirmed the substance of the approach in paragraph (2). In particular, the Working Group affirmed that the concept of "effectiveness" as used in the draft Convention was a narrow one, referring to the "guarantee period", i.e., the period of time during which the undertaking was available for a conforming demand for payment to be made by the beneficiary. It was noted that the term was not intended to take a position on doctrinal questions of the nature of the undertaking, but merely to answer the practical question, when the undertaking was available to the beneficiary to demand payment. Furthermore, it was pointed out, the rule on effectiveness was in line with the rule on

issuance taking place when the undertaking left the sphere of control of the issuer, while still permitting the parties to stipulate a later commencement of availability for payment.

16. In view of that understanding of the limited scope of the reference to "effectiveness", the Working Group referred favourably to the drafting group a suggestion to forgo entirely use of the term "effectiveness", which appeared in articles 7(2) and 10, utilizing instead a descriptive formulation such as that presented earlier in A/CN.9/WG.II/WP.80 in a proposed definition in article 6 (j) of "effectiveness" ("'effectiveness' ... means that it ... is open for the beneficiary to make a conforming demand for payment"). Such an approach was deemed preferable to attempting to reintroduce a definition of "effectiveness", as had been earlier proposed for article 6 but not accepted by the Working Group.

17. As regards the separate concept of irrevocability, also dealt with in paragraph (2), the Working Group affirmed the rule that the undertaking assumed irrevocability at the moment of issuance, and that revocability therefore had to be determined upon issuance. It was noted that questions concerning possible changes in such an irrevocable undertaking would be dealt with in the rule in article 8 concerning amendment.

18. However, with a view to achieving greater clarity as to the distinct meaning of the reference to irrevocability, the Working Group accepted and referred to the drafting group a suggestion that the rules on effectiveness and on irrevocability should be dealt with in separate paragraphs. Such an approach gained support over a suggestion that the matter could be dealt with by a concise statement such as: "an undertaking is effective and irrevocable upon issuance unless otherwise stipulated". It was also noted that differences of a drafting nature between the expression "upon issuance", used with respect to effectiveness, and the expression "when issued", used with respect to irrevocability, were not intended to have substantive import and would be avoided.

## Article 8. Amendment

### Paragraph (1)

19. A query was raised as to whether the effect of paragraph (1) was to allow oral amendments. It was pointed out that, if this was the case, then it was incorrect to speak in paragraph (2) of an amendment being "issued". A further query in this regard was whether a notice of acceptance of an oral amendment could also be made orally. It was pointed out, however, that the Working Group had agreed to allow oral amendments (A/CN.9/391, para. 65) only where such a form had been stipulated in the undertaking.

20. A suggestion was made that the current formulation of paragraph (1) was not clear as to whether it addressed only the form to which the amendment must conform to be effective or whether it also referred to other procedures to which the amendment must conform. In support of better clarifying the matter, it was stated that, in some instances, amendments to undertakings were made by means of procedures that were not stipulated in the undertaking and it was not clear whether these types of procedures were meant to be covered in paragraph (1). The prevailing view, however, was to maintain the current formulation of paragraph (1). The view was shared that the word "form" in this context was not intended to refer to any procedures that might be used to arrive at an amendment.

After deliberation, the Working Group decided to retain paragraph (1) without changes, subject to alignment of the different language versions by the drafting group as regards the word "form".

Paragraph (2)

21. A proposal was made for the deletion in paragraph (2) of the exemption that allowed amendments extending the validity period of the undertaking to take effect upon issuance, without any notice of acceptance required from the beneficiary. It was explained that the assumption behind the exemption was that such amendments were always to the advantage of the beneficiary. However, it was pointed out that it was not always the case that amendments to extend the validity period were to the advantage of the beneficiary. The primary practical example cited in this regard involved variable-interest-rate financial stand-bys, which, if extended, might deprive the beneficiary of electing a more advantageous fixed interest rate at the end of the initial validity period. Another example given was where the guarantor/issuer extended the validity period without the consent of the counter-guarantor, who then withdrew the counter-guarantee, thus exposing the beneficiary to risk of non-payment. It was stated that, in such situations, the beneficiary should be afforded the option of accepting or rejecting an extension. Furthermore, it was stated, making such amendments subject to acceptance by the beneficiary would provide certainty to the bank and the beneficiary as to their position, in particular since the beneficiary had a number of ways of expressing consent, including by presenting a demand for payment in accordance with the terms of the amendment.

22. In response, it was pointed out that, without such an exemption, once an amendment to extend the validity period was made, it would be binding and irrevocable as against the guarantor/issuer, but the position as regards the beneficiary-guarantor/issuer relationship (and thus the exposure of the guarantor/issuer) would be unclear until the beneficiary reacted to the amendment. In this regard it was noted that, in practice, the bulk of the amendments made related to the extension of the period of validity and that, in most instances, the beneficiary would not be expected to actually express consent to the amendment in a formal manner. Moreover, the extension of the validity period could not be imposed upon an unwilling beneficiary since he could present a demand for payment within the original period. The view was thus expressed that to require the beneficiary always to express consent to such amendments in order for them to have effect would not be consistent with prevailing practice. It was further stated that, since parties to the undertaking had the option to agree on other rules regarding amendments, those parties who needed acceptance by the beneficiary of amendments extending the validity period could so stipulate in the undertaking.

23. In conclusion, the Working Group was reluctant to alter the approach set forth in paragraph (2). It was noted that the exemption was a narrow one limited only to those instances where an amendment had the sole effect of extending the period of validity and that this point might be made even clearer by more restrictive wording. It was further noted that those parties who wished to have such amendments take effect only upon acceptance by the beneficiary could so stipulate in the undertaking.

24. As a matter of drafting, the suggestion was made and referred to the drafting group that the text should clearly indicate that the non-mandatory nature of the rule set forth in paragraph (2) also applied to the words at the end of the paragraph ("any other amendment becomes effective when the guarantor/issuer receives a notice of acceptance by the beneficiary"). The suggestion was referred to the drafting group.

Paragraph (3)

25. The Working Group found the substance of paragraph (3) to be generally acceptable. A proposal to add a reference to the counter-guarantor did not gain support. It was pointed out that the Working Group had in earlier sessions discussed such a proposal and had decided that it was not necessary to make any specific reference to the counter-guarantor (see, e.g., A/CN.9/372, para. 132).

Article 9. Transfer of beneficiary's right to demand payment

26. Suggestions were made with a view to making more precise the meaning of article 9. One suggestion was to use words along the lines of "open for a request for transfer". Another proposal was to refer specifically to obtaining the consent of the principal/applicant, unless it could be assumed that a transfer was an amendment and therefore subject to the protection afforded to the principal/applicant by article 8(3). After deliberation, the Working Group affirmed the approach in the current text.

Article 9 bis. Assignments of proceeds

27. The Working Group exchanged views as to whether the terminology and scope of article 9 bis might be made more precise. The aim would be to make it clearer that the provision established a right independent of what might necessarily be available under applicable domestic law, without thereby excluding the application of that law with respect to aspects of the assignment not covered by the draft Convention.

28. Suggestions included: to refer specifically to continued applicability of domestic law; to refer in the title to "irrevocable" assignment, since this was the type of assignment of commercial significance; to avoid altogether the use of the term "assignment" so as to avoid confusion with the general law of assignment, and to use instead a term such as "payment order", or words to the effect that "the beneficiary may authorize a third party to receive payment"; to add a more explicit statement concerning the key obligation of the guarantor/issuer in the assignment context, which was to follow the payment instruction; and to add to paragraph (1) a reference to a requirement of form in accordance with article 7 (1).

29. The Working Group then considered a proposed redraft of article 9 bis along the following lines, intended to reflect various proposals that had been made:

"Article 9 bis. [Irrevocable] assignment of proceeds

(1) Unless otherwise stipulated in the undertaking or elsewhere agreed, the beneficiary may notify the party obligated to pay of its irrevocable direction to pay to another person the proceeds to which it is or may be entitled.

(2) If the obligor agrees to pay the proceeds as directed which agreement is communicated to the person to be paid in the form referred to in paragraph (1) of article 7, the obligor is obligated to do so without regard to further instruction from the beneficiary.

(3) [Current article 9 bis, paragraph (2)]"

30. In support of the above proposal, it was emphasized that the intent was not to establish a new substantive rule as such, but to reflect and accord greater legal certainty to existing practice. It would do so by clarifying the twin requirements for effectuating assignment, i.e., notice from the beneficiary and acknowledgement by the guarantor/issuer on which, for example, such financing by an assignee of proceeds relied.

31. It was further suggested that the proposed text would usefully state clearly what was said to be the critical element in the assignment of proceeds, the obligation of the guarantor/issuer to implement a payment instruction the receipt of which has been acknowledged by the guarantor/issuer. In response to a concern that such a definitive statement of the obligation to the assignee might contravene the rule on fraudulent demands for payment, it was pointed out that "proceeds" did not arise until the point of finality. One could not speak of there being "proceeds" at an earlier point, which might preclude blocking of payment of an improper demand.

32. After considering the preceding suggestions, the Working Group decided rather to retain the existing formulation. For example, it was felt that the current text took adequate account of the obligation of the guarantor/issuer, as well as of the continued applicability of domestic law. Accordingly, the Working Group decided that it was not necessary to add additional references to irrevocability, or to a form requirement in paragraph (1) with respect to a waiver of the right to assign proceeds. At the same time, the Working Group affirmed that the notice of assignment, in order to be reliable, needed to originate from the beneficiary, without thereby requiring physical delivery by the beneficiary, and that article 9 bis did not preclude partial assignment. Lastly, the drafting group was requested to consider possible clarification of the term "obligor".

## Article 10. Cessation of effectiveness of undertaking

### Paragraph (1)

### Subparagraphs (a) and (b)

33. The Working Group found the substance of subparagraphs (a) and (b) to be generally acceptable.

### Subparagraph (c)

34. A number of concerns were raised with regard to subparagraph (c). One such concern involved the possibility of automatic renewal of undertakings. Another concern was that, once the amount available under the undertaking had been paid, the automatic renewal should not be referred to as a renewal of the undertaking as such but as an increase in the amount payable. As a matter of drafting, it was also suggested that the second reference in the subparagraph to "amount available" should be changed to "amount paid" so as to clarify that partial payment had already been made. After deliberation, however, the prevailing view was to retain subparagraph (c) unchanged, subject to any drafting clarifications by the drafting group.

Subparagraph (d)

35. The Working Group found the substance of subparagraph (d) to be generally acceptable.

Paragraph (1 bis)

36. The Working Group agreed to delete paragraph (1 bis) on the understanding that the decision to forgo the use of the term "effectiveness" and instead to use a more descriptive formulation (see para. 16) rendered the paragraph redundant.

Paragraph (2)

37. The Working Group noted that the draft of paragraph (2) was in accordance with decisions taken by the Working Group earlier (see A/CN.9/391, paras. 82-89) with regard to the issue of the effect of return of the documents embodying the undertaking. However, a number of suggestions aimed at improving the drafting were made. One such suggestion concerned the provision permitting the guarantor/issuer and the beneficiary to agree that return of the document embodying the undertaking would, by itself and independent of the expiry events in subparagraph (a) or (b), trigger the cessation of the undertaking, provided that the effectiveness of the undertaking had not ceased by virtue of subparagraph (c) or (d). It was suggested that the use of the words "either alone" did not make this sufficiently clear and that a formulation to the effect that "the undertaking ceased to be effective upon such return" would be preferable. Another suggestion along the same lines, also of a drafting nature, was to express better the decision that retention of the documents after payment of the undertaking or after its expiry did not preserve any rights of the beneficiary. It was suggested accordingly that the last phrase of paragraph (2) could read along the lines of "regardless of such stipulation, the undertaking always ceases to be effective when full payment is made according to paragraph (1) (c) of this article or upon expiry of the validity period in accordance with article 11". After deliberation, these suggestions were found to be generally acceptable and were referred to the drafting group.

38. With regard to the words in square brackets "[, or after full payment has been made]", the view was expressed that they could be deleted since this issue was already regulated by paragraph (1) (c). The prevailing view, however, favoured the current formulation as it was felt to clarify usefully that retention of the document after payment did not preserve any rights of the beneficiary.

## Article 11. Expiry

Chapeau

39. A suggestion was made to add the words "unless otherwise stipulated" to the beginning of the chapeau. It was noted, however, that, while this may be of relevance to subparagraph (c), the effect of which would be to subject to party autonomy the rule providing for expiry of the undertaking after six years from the date of issuance if the undertaking did not set an expiry date, it could not relate to subparagraph (a) or (b). The prevailing view, however, was to leave the substance of this rule without any changes, in particular since the present formulation had been arrived at after extensive discussions by the Working Group (see A/CN.9/391, para. 97), including consideration of the question of undertakings of indefinite duration.

Subparagraphs (a) and (b)

40. The Working Group found the substance of subparagraphs (a) and (b) to be generally acceptable.

Subparagraph (c)

41. A suggestion was made that subparagraph (c) should be made subject to national law on the basis that, in some jurisdictions, undertakings that did not set an expiry date were considered void. However, this suggestion did not attract sufficient support. It was noted that subjecting the rule in the draft Convention to national law would cause uncertainty by pointing to two possibilities, i.e., that an undertaking that was subject to the Convention would either expire after six years or be void ab initio. The Working Group therefore retained the substance of subparagraph (c) without change, recalling at the same time that undertakings of a long duration would still be possible under the draft Convention. This would be possible by setting a distant expiry date or by providing for automatic renewal.

## CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

### Article 12. Determination of rights and obligations

Paragraph (1)

42. The Working Group found the substance of paragraph (1) to be generally acceptable.

Paragraph (2)

43. It was noted that the square brackets around the word "[independent]" would be deleted in line with earlier decisions to refer to "independent guarantees".

44. It was pointed out that there was a difference between articles 12 (2), 13 (1) and 16 (1), in that, while article 12 (2) referred to "accepted international rules and usages of [independent] guarantee or stand-by letter of credit practice", the reference in article 13 (1) was to "generally accepted standards of international practice of independent guarantees or stand-by letters of credit" and the reference in article 16 (1) was to "applicable international standards of independent guarantee or stand-by letter of credit practice". It was further pointed out that, while previous discussions made it clear that the reference in article 13 (1) was meant to cover standards such as those contained in the UCP 500 and in the URDG (see A/CN.9/391, para.106), it was not clear that this was also the intention with regard to articles 12 (2) and 16 (1). A proposal was therefore made to align the language in those articles.

45. In response, it was stated that the difference arose owing to the difference in context of the three articles. It was pointed out that, while article 12 (2) dealt with the interpretation of terms and conditions of the undertaking where the international rules and usages would assist in filling in any gaps in the undertaking, article 16 was more geared to ensuring the compliance of the guarantor/issuer with international standards of practice. However, the Working Group affirmed also that generally it was intended to refer to "international practice".

46. Another concern raised along the same lines was that, in the current article 5 (see A/CN.9/405, annex), the formulation "international independent guarantee and stand-by letter of credit practice" created ambiguity in that the word "international" could be interpreted to qualify the independent guarantee while it was meant to refer to international practice. The Working Group therefore decided to revert to the earlier formulation of article 5 as found in document A/CN.9/WG.II/WP.83 and which referred to "the international practice of independent guarantees and stand-by letters of credit".

47. Subject to any clarifications by the drafting group, the Working Group decided to maintain the substance of article 12 (2) without change.

Article 13. [Standard of conduct and] liability of guarantor/issuer

48. The Working Group, in line with the discussion of the formulation of references to standards of international practice that had taken place in the context of article 12, affirmed the formulation of the reference to "international practice" found in paragraph (1).

49. Some questions were raised as to the effect and scope of the rule in article 13. One question was whether article 13 should be understood to apply not only to the guarantor/issuer - beneficiary relationship, but also to the relationship of the guarantor/issuer to the principal/applicant. The generally held understanding in the Working Group affirmed applicability also to the latter relationship, in so far as that relationship could be affected by conduct of the guarantor/issuer in discharging its obligations under the undertaking and the Convention. This was said to be indicated, for example, by the fact that the lowering of the standard of care by agreement, a possibility envisaged in article 13, involved the agreement of the principal/applicant.

50. Another question asked was whether article 13 might not raise difficulties of application in some legal systems where its concepts might be alien. For example, it was emphasized that there might be jurisdictions in which the lowering of the standard to exempt negligence short of gross negligence would not be countenanced, or in which the notion of the guarantor/issuer's negligence would be deemed irrelevant vis-à-vis the beneficiary demanding payment, or in which there would not be a tradition of relying on notions such as "good faith" or "gross negligence".

51. Suggestions to remedy those matters included deletion of the word "grossly" in paragraph (2), with the effect of precluding exemptions of liability for negligence. The suggestion was also made that in fact no provision needed to be made expressly for exemptions from simple negligence if this was agreed by the parties, since such an agreement would simply mean that a lower standard was being applied.

52. After deliberations, the prevailing view in the Working Group was to retain the existing text basically along its present lines, which had been decided upon earlier after detailed consideration (A/CN.9/374, para. 76). In affirming the existing approach, the Working Group noted that the present approach had its foundation in practice, since it was not uncommon for parties, for commercial reasons, to agree to undertakings with a lowered standard of examination of demands for payment.

Article 14. Demand

53. The Working Group found the substance of article 14 to be generally acceptable and referred it to the drafting group.

Article 16. Examination of demand and accompanying documents

Paragraph (1)

54. The question was raised as to the relevance of the standard enunciated in article 16 to the guarantor/issuer's relationship to the principal/applicant. The prevailing view was that article 16 could not be isolated from and had implications for that relationship. It was again affirmed that the provision should not be construed as preventing the principal/applicant and the guarantor/issuer from establishing agreed standards (see previous discussion in A/CN.9/391, para. 120).

55. Furthermore, the Working Group declined to accept a suggestion to delete the reference in the second sentence to a standard for examination of the demand, on the ground that the standard enunciated in article 13 was sufficient to cover the situation. It was noted that article 16 usefully stated the standard to be followed in the specific task of examination of documents, and a description of what was meant by the notion of "facial compliance". At the same time, it was pointed out that examinations of acts or events within the sphere of the guarantor/issuer could be considered to be governed by the general standard of care in article 13, if they were not considered covered by the standard for examination of documents.

56. The Working Group noted that the current draft implemented the view of the Working Group that the provision should be formulated so as to make clear that the demand itself, apart from any accompanying documents, should be considered a document for the purposes of the draft Convention (A/CN.9/391, para. 121).

57. Another question concerning the scope of article 16 was whether it applied to entities other than the guarantor/issuer that had the role of examining documents and deciding whether a demand should be paid. Wording proposed to the effect of such applicability included "the guarantor/issuer, or other person authorized to examine the demand".

58. It was pointed out that this was a form of the question that had been raised at other points, namely, the question of the applicability of certain of the rules to parties other than those specifically referred to. Such an extension had already been made expressly in articles 9 and 9 bis, and might be considered for other provisions, for example, articles 12(1), 13(1), 17(1), (2), (3) and (4), and 20.

59. Objections were raised to the inclusion of any reference to a third party in paragraph (1) since that might be read as if this rule created an obligation of that third party vis-a-vis the beneficiary. It was stated that this would go far beyond the scope of paragraph (1).

60. The Working Group preferred not to make an express statement to that effect, since the implications of such an express inclusion could not be fully considered at this stage.

Paragraph (2)

61. The Working Group resumed its consideration of the question of how exactly to express the rule concerning the length of time to be allowed for the examination of the demand for payment and any accompanying documents (see A/CN.9/391, para. 122), in particular whether to use the expression "banking days" or the expression "business days". The latter expression, it was noted, took account of the fact that the draft Convention assumed the possibility of issuance by a non-bank entity. At the same time, the Working Group noted that the provision should not be construed as permitting the guarantor/issuer to set its business days without reference to the ordinary or general practice that prevailed. On the basis that the above understanding of the current text would be sufficiently clear, the Working Group decided not to adopt alternative formulations such as "its business days", or "days on which it is open for business".

62. A further possible clarification of the current text explored by the Working Group concerned the place at which the demand and accompanying documents must arrive in order for the seven-day period to begin to run. Proposals to address this aspect were motivated by a concern that otherwise the beneficiary would be unclear as to how much time could be taken to examine the demand, particularly when the demand was presented to a person other than the guarantor/issuer.

63. One view was that the provision should state explicitly that the time period would begin to run upon receipt of the demand by the guarantor/issuer or some other person designated to examine the demand. It was pointed out that such an approach would clarify that the time period should not begin to run against the guarantor/issuer when he might not have yet even received the demand, which was said to be particularly important in view of the preclusion effect of article 17(4). The question was raised with regard to that approach as to whether there would be excessive uncertainty as to how much time was permitted for the demand to reach the guarantor/issuer.

64. Another view was that clarity for the beneficiary could best be achieved were the provision to say that the time period began upon submission of the demand at the place where according to article 14 the demand had to be made. Thus the period might begin to run even if the submission were made to a bank that merely remitted the demand to the guarantor/issuer. To this effect, a text along the following lines was proposed: "the demand and any accompanying documents shall be examined within ...". The Working Group was reminded that such a formulation would permit the parties to set a longer time period if they felt such an adjustment to be necessary.

65. A proposal was also made to the effect that it would be best to keep paragraph (2) stated in a general and flexible manner, for example, along the lines "... reasonable time, from the time of a demand being made in accordance with article 14".

66. A further proposal was to model the provision more closely on the relevant portions of articles 13 and 14 of the Uniform Customs and Practice for Documentary Credits (UCP). Some hesitation was expressed, however, as it was felt that this would not provide significant added clarity. For example, the question was raised whether the UCP provisions, which operate also as interbank rules, could be interpreted to provide for an accumulation of seven-day periods by each of the banks mentioned, thus leaving uncertainty as to when payment could be expected.

67. After considering the above proposals, the Working Group took the view that a formulation

flexible to take account of the widely varying circumstances encountered in practice, and that it would be compatible with UCP if the latter were incorporated by the parties. It was noted, however, that the exact formulation of article 16 might in particular be considered further at a later stage.

Article 17. Payment or rejection of demand

Paragraphs (1) and (1 bis)

68. The Working Group found the provisions of paragraphs (1) and (1 bis) to be generally acceptable.

Paragraph (2)

69. As had been the case in previous sessions, the view was expressed that the current formulation of paragraph (2) was inappropriate as it placed the guarantor in the situation of having to ascertain the authenticity of any allegations that a principal/applicant may make that a demand was improper, which allegations may sometimes be contained in a large number of documents. It was stated that such a requirement would involve the guarantor/issuer in disputes regarding the underlying transaction and thus jeopardize the independence of the instrument. The view was expressed that such a provision shifted more obligations onto the guarantor/issuer than was currently the case in commercial practice, which could impact on the acceptability of the draft Convention. It was therefore suggested to provide the guarantor/issuer with the discretion to make payment in case of doubt that the demand was improper.

70. In response, it was stated that the basic philosophy underlying paragraph (2) was sound since the obligation not to make payment on an improper demand was only applicable under very restrictive circumstances. It must be not only manifest and clear that the demand was improper as defined in article 19, but also that payment under such circumstances would not be in good faith. It was stated that to provide an option to pay under such circumstances would make the guarantor/issuer a knowing participant in an improper demand. However, the view was expressed that words such as "is shown facts" in paragraph (2) might give the impression that the guarantor/issuer was under some obligation to investigate any allegations made. It was proposed that a formulation that better captured the intention of the Working Group could read along the following lines: "where, in the view of the guarantor/issuer, a demand is manifestly and clearly improper as defined in article 19, such that making the payment would not be in good faith, the guarantor/issuer shall not make payment to the beneficiary".

71. The Working Group expressed support for such a formulation. A further proposal, designed to protect the guarantor/issuer against liability for rejecting an apparently fraudulent demand, was to also provide that the obligation not to make payment would not be mandatory unless the principal/applicant agreed to seek the determination of a court or arbitral tribunal regarding the improper demand or to reimburse or indemnify the guarantor/issuer if the beneficiary sued. Those proposals were referred to the drafting group.

72. A query was made as to whether paragraph (2) covered the case of innocent third parties. It was explained that, in some jurisdictions, if the party requesting payment was a third party who had taken up the instrument for value but was innocent of fraud on the instrument, then the guarantor/issuer was

under an obligation to make payment. It was pointed out, however, that using the words "payment to the beneficiary" in paragraph (2) would exclude payment to such third parties from the operation of the paragraph.

Paragraphs (3) and (4)

73. Differing views were expressed as to the decision to be taken by the Working Group on the retention or deletion of paragraph (4), which precluded rejection of a demand on grounds not properly notified to the beneficiary. Support for deletion was expressed from the viewpoint that a strict exclusion rule such as that found in paragraph (4) was overly burdensome on the guarantor/issuer. It was further stated that, though such a rule might be of relevance with regard to commercial letters of credit, it was not appropriate at least with regard to guarantees and should be left to national law. It was further stated that the sanction imposed by the rule was disproportionate and that it might encourage beneficiaries to make spurious claims.

74. Contrary views, however, were expressed in support of retention of the provision. It was pointed out that the rule reflected current practice with regard to stand-by letters of credit. Furthermore, it was stated, the rule was important in that it provided discipline and rigour to the undertaking, thus investing the undertaking with the necessary degree of finality. It was also suggested that deleting the paragraph would give rise to inconsistency between the draft Convention and the Uniform Customs and Practice for Documentary Credits (UCP), and would also leave a gap in the draft Convention as there would be no sanction to a breach of article 16 (2).

75. After deliberation, the prevailing view in the Working Group was in favour of deletion of paragraph (4). The Working Group agreed, however, that such a deletion did not prejudice the right of parties to apply an exclusionary rule such as that found in UCP. The Working Group also accepted and referred to the drafting group a proposal that article 16 (2) should require the guarantor/issuer to notify the beneficiary within seven days in case of rejection of the demand and that such a notice would take effect upon dispatch. The Working Group also agreed that providing for notice of rejection in article 16 (2) rendered paragraph (3) of article 17 unnecessary. Paragraph (3) was, therefore, deleted.

## Article 19. Improper demand

76. The Working Group noted that the present formulation reflected its decision that applicability of subparagraph (a) should not depend on the beneficiary having been itself involved in the falsification of a document (A/CN.9/388, para. 17), a factor that had been cited in a number of judicial decisions. It was noted that a significant factor in those cases, absent in the types of undertakings covered by the draft Convention, was the presence of documents whose commercial value survived the falsification unimpaired.

77. Without seeking to change the substance of rules in the existing text of the draft Convention, the Working Group referred to the drafting group a proposal aimed at simplifying and clarifying the provisions on the response of the guarantor/issuer to improper demands. According to that proposal, the provisions obligating the guarantor/issuer to refuse payment in the defined circumstances would be congregated in article 19, in particular paragraph (2) of article 17. This reordering of the provisions would obviate the need to use or define the term "improper demand". Article 17 would be further

reduced in size, since it had been agreed that the rule in paragraph (3) of article 17 would be dealt with in an agreed addition to paragraph (2) of article 16, to reflect the requirement of notification of rejection (see para. 75). A further suggestion of a drafting nature was to reorder the articles of the draft Convention so that the provisions in article 20 concerning set-off would immediately follow article 17.

78. Suggestions for a title for such a reordered article 19 included, for example, "defences to payment" and "exceptions to payment", although the concern was expressed that such expressions might have an overly technical meaning in some jurisdictions. Another suggestion was "fraud and abuse", without however defining those terms. The matter was referred to the drafting group.

### Article 20. Set-off

79. The Working Group found the substance of article 20 to be generally acceptable, and referred it to the drafting group, in particular for consideration of the suggestion to relocate it.

## CHAPTER V. [PROVISIONAL COURT MEASURES]

### Article 21. Provisional court measures

Paragraph (1)

80. The Working Group noted that the decision to delete the phrase "improper demand" in article 19 would require a similar deletion in paragraph (1), to be replaced by a cross-reference to the elements in article 19 (1) that triggered a duty of non-payment.

81. A view was expressed that the test of "high probability" for the granting of provisional measures would be considered as too low in some jurisdictions and that it should rather be formulated along the lines of "manifest and clear". The Working Group was reluctant, however, to change its earlier decision to make the test one of "high probability", in particular since, if the test were set too high, the court would in essence be making a final determination of the issue.

82. With regard to the last phrase of paragraph (1), regarding the balancing of interests in the determination of whether to issue a provisional measure, it was pointed out that, in some jurisdictions, the court would also have to take into account the likely harm to be suffered by the guarantor/issuer and the beneficiary upon issuance of provisional measures, and that this was not adequately reflected in the current text. It was pointed out, however, that the understanding of the Working Group when this issue was discussed earlier was that the formulation in paragraph (1) did not preclude the interests of the beneficiary being taken into account (see A/CN.9/405, para. 41).

Paragraph (3)

83. A query was raised as to whether the import of paragraph (3) was that it would be the obligation of the beneficiary to provide security. In response, it was pointed out that the principal/applicant,

being the party making the application for provisional measures, would be the party providing the security.

Paragraph (4)

84. The Working Group agreed that the import of paragraph (4) was that provisional measures were not available in cases of insolvency or bankruptcy of the principal/applicant, since those were not instances of an improper demand.

85. The suggestion was made that the reference in paragraph (4) to "an illegal purpose" was not clear as the phrase had a very broad meaning in some jurisdictions. It was suggested that a better formulation would be to make reference to "a criminal purpose", which would exclude matters regulated by other areas of law such as, for example, a situation where a guarantee would relate to a transaction that might subsequently be ruled to be in contravention of anti-trust laws. In this regard, a proposal was made that reference would have to be made to international criminal acts as the draft Convention dealt with instruments of an international character. However, this was objected to on the basis that such a phrase would be unclear as to what constituted international criminal acts and would also exempt criminal acts of a national character from the application of paragraph (4).

86. The proposal to use the words "criminal purpose" themselves was questioned. The view was expressed that the phrase was itself too broad since, in some jurisdictions, such matters as anti-trust and securities violations were considered criminal acts. A proposal was made for the deletion of the reference to "illegal purpose" in paragraph (4) on the basis that the paragraph would only be applicable in a very limited number of cases, since, in accordance with paragraph (1), provisional court measures could only be granted upon an application of the principal/applicant. This proposal, however, did not gain support, although it was recognized that, for reasons given in support of the proposal, the practical scope of application of the provision was rather limited. Another proposal was to replace the reference to "illegal purpose" with the term "public order". This was also objected to, on the basis that the Working Group had discussed such a formulation in earlier sessions and found it to be too broad. Yet another proposal was to delete paragraph (4) in its entirety on the basis that it was superfluous. It was pointed out, however, that such a deletion would lead to the erroneous implication that provisional measures could be granted for claims of non-conformity.

87. After deliberation and consideration of the various proposals, the Working Group decided to replace the words "an illegal purpose" with the words "criminal purpose" and referred the matter to the drafting group.

## CHAPTER VII. CONFLICT OF LAWS

### Article 26. Choice of applicable law

88. The Working Group noted that the draft Convention did not regulate questions of capacity to issue undertakings, a matter left to the applicable national law.

89. The drafting group was requested to implement a suggestion that paragraph (3) of article 1, which provided for application of chapter VII even when the Convention as such did not apply to a

given undertaking, should make it clear that such application was nevertheless confined to the sphere of international undertakings.

90. Various proposals were made with a view to clarifying article 26. The suggestions discussed included replacement of the word "demonstrated" by "implicit", although the Working Group was reminded that the latter word had earlier been considered insufficiently precise. Another suggestion was to avoid the word "designation", as this might inadvertently raise theoretical questions as to the legal nature of the undertaking. A further suggestion was to refer to the possibility of demonstration of a choice of law from the "circumstances" of the case, an addition that did not attract sufficient support.

91. The Working Group agreed that article 26 took cognizance of and recognized that in practice the designation of applicable law was typically a unilateral decision of the guarantor/issuer indicated in the terms of the undertaking, and not necessarily a matter of specific negotiation and agreement with the beneficiary.

92. Affirming the substance of the rule in the existing text, the Working Group referred article 26 to the drafting group for further refinement, for example, by stating the provision more simply, in one sentence.

93. The Working Group considered whether to add a reference to form in accordance with article 7 (1), as regards agreements outside the undertaking ("agreements elsewhere"). In considering article 26, the Working Group noted that the provision enabled the draft Convention to take account of ad hoc agreements concerning applicable law, which might be reached after a dispute had arisen. It was further observed that such agreements might or might not be considered amendments of the undertaking, depending upon whether they involved a change made in a stipulation in the undertaking. The Working Group agreed not to add a specific reference to a form requirement in accordance with article 7.

94. The Working Group also took the occasion to affirm that the text did not preclude the parties from subjecting only select aspects of the undertaking to the chosen law, and similar practices sometimes referred to as dépeçage.

## Article 27. Determination of applicable law

95. The Working Group examined further its choice made earlier that the connecting factor for determination of the applicable law in the absence of a choice by the parties should be the place of business of the guarantor/issuer at which the undertaking was issued (A/CN.9/405, para. 52). The concern was expressed that such a formulation would not provide sufficient clarity when an undertaking was notified or advised to the beneficiary by an entity unaffiliated to the guarantor/issuer, or when an undertaking happened to be issued at a location remote from a place of business of the guarantor/issuer. It was said to be potentially unclear how to apply to such a case the definition of issuance set forth in article 7, which provided that issuance took place when the undertaking left the sphere of control of the guarantor/issuer.

96. Alternative approaches suggested included using a connecting factor other than issuance, such as "law of place of business of the guarantor/issuer that has the closest connection to the undertaking", or

to track the formulation in article 27 of the Uniform Rules for Demand Guarantees (URDG) with a view to greater clarity when multiple entities were involved in issuance. It was stated, however, that the URDG provision, which referred to the "branch" that issued when the guarantor/issuer had more than one place of business, still left room for questions, in particular when an entity that was not a branch of the guarantor/issuer was involved somehow in the issuance, for example, by acting as an advising bank.

97. The view was further expressed that the uncertainty being discussed suggested that it might be preferable to refer to receipt of the undertaking as the key event in issuance. In response, it was stated that abandonment of the formulation "leaving the sphere of control of the guarantor/issuer" was not warranted, since that expression did not mean that issuance took place only when there was no possibility whatsoever left of recall of the undertaking. For example, it was pointed out that, even when a courier was involved, the possibility existed for a guarantor/issuer to cancel delivery instructions. Rather, the rule should be understood, it was stated, to mean leaving the normal sphere of operations of the guarantor/issuer. Furthermore, it was stated that, since the element of the guarantor/issuer's will was necessary for issuance, the loss of an undertaking instrument by the guarantor/issuer should not be considered to constitute valid issuance in the sense of paragraph (1).

98. After considering the various views expressed, the Working Group retained in essence the existing formulation, linking determination of applicable law to place of issuance. It was felt that this was the clearest possible factor, and it took adequate account of the various possibilities that might arise in issuance. It was noted that the existing approach in article 27 was in line with the prevailing assumption in practice and the underlying notions of applicability of regulatory and supervisory authority, for example, with respect to capital-adequacy matters. It was furthermore pointed out that a reference to place of issuance in article 27 would be consistent with the approach followed elsewhere in the draft Convention, in particular in articles 1, 4 and 7.

## CHAPTER VI. JURISDICTION

99. As had been decided at the twenty-second session (A/CN.9/405, para. 48), the Working Group proceeded to a review of a possible chapter on jurisdiction, now that it had completed its review of the other portions of the draft Convention.

100. In order to assist the Working Group in reaching a decision both as to the basic question of whether to include a chapter on jurisdiction, as well as the possible contents of such a chapter, the Secretariat presented draft articles on certain issues suggested by the deliberations at the twenty-second session. The Secretariat reported that provisions proposed flowed from consultations that had taken place at earlier stages with the Hague Conference on Private International Law, and that they were also prepared taking into account interventions made by the Hague Conference at earlier sessions.

101. Differing views continued to be expressed as to whether such a chapter should be included, or if included, made subject to the right of reservation by contracting States. Among the grounds cited for refraining from including the chapter were that it was not traditional for a substantive-law convention to include jurisdiction provisions, that there was a possibility that the Hague Conference would embark on a general international convention on jurisdiction and recognition and enforcement, and that the draft Convention should therefore not enter into the field of jurisdiction.

102. In support of retaining chapter VI, it was stated that, with the proposed additional provisions, the principal concerns expressed at previous sessions had been addressed. In particular, the concern as to the completeness of chapter VI would be offset by the proposed additional provisions on recognition and enforcement of judgments and on lis pendens. It was pointed out that, as had been suggested, the proposed new provisions were patterned after the system found in the Convention on Civil Liability for Damage Resulting from Activities Dangerous to the Environment (Lugano, 21 June 1993). The Working Group noted that that Convention was an example of a substantive-law Convention containing provisions on jurisdiction.

103. In accordance with the agreed procedure, the Working Group deferred a decision on whether to retain chapter VI until completion of the review of the draft provisions of the chapter, on which it was about to embark.

104. The Working Group noted that, if chapter VI were retained, the drafting group would revise the text of article 1 (3), which provided for application of chapter VI even when the Convention as such did not apply to a given undertaking, to make it clear that such application would be nevertheless confined to the sphere of international undertakings as defined in article 2.

## Article 24. Choice of court or arbitration

105. The view was expressed that the provision should make it clear that it referred to disputes between the guarantor/issuer and the beneficiary, which were the only disputes that those parties could cover in their dispute settlement agreement. The view was also expressed that the provision should not address the question of exclusivity of jurisdiction of the chosen court.

106. An objection was raised as to inclusion of the form requirement in accordance with article 7 (1) as regards an agreement by the parties outside of the undertaking. It was suggested that this requirement might run counter to the extent of discretion accorded to judges in some legal systems.

107. A number of interventions were made in support of deleting the limitation of the scope of the provision to cases involving at least one party with a place of business in a contracting State. It was recalled in response, however, that the matter involved the extent to which a State would be willing to commit judicial resources to cases not involving parties not covered by the draft Convention.

## Article 24 bis. Jurisdiction of other courts

108. The following redraft of article 24 bis was considered by the Working Group, as a possible alternative to the text appearing in document A/CN.9/WG.II/WP.83:

> "(1) Every court other than the court or courts chosen in accordance with article 24 shall decline jurisdiction, except:
>
> (a) Where the choice of court made by the guarantor/issuer and the beneficiary is not exclusive;
>
> (b) For the purpose of provisional court measures.

[(2) Where proceedings involving the same cause of action and between the same parties are brought in the courts of different contracting States, any court other than the court first seized shall of its own motion stay its proceedings until such time as the jurisdiction of the court first seized is established [in accordance with article 24 or 25]. Where the jurisdiction of the court first seized is established, any court other than the court first seized shall decline jurisdiction in favour of the court.]"

109. The Working Group noted that the proposed new text did not contain the provision formerly found in subparagraph (d) of the version in document A/CN.9/WG.II/WP.83. It was pointed out that subparagraph (d), which had provided for an exception to exclusivity where a decision of the chosen court was incapable of recognition and enforcement, would no longer be necessary if the proposed new article 25 bis, which provided a recognition and enforcement scheme, were added.

110. As regards the deletion of subparagraph (e) of the earlier text, which provided for an exception to exclusivity where the chosen court declined jurisdiction, it was suggested that reinstatement of that provision might have to be contemplated if the Working Group deleted the limitation in article 24 to parties from contracting States (see para. 107).

111. It was proposed to specify in paragraph (1) (b) that it referred to provisional court measures pursuant to article 21. In response, it was suggested that such a limitation would be unwarranted, since the provision dealt with a consensual attribution of jurisdiction by the parties. It was further stated that such a limitation did, however, have a role to play in article 25, which involved determination of jurisdiction in the absence of a choice by the parties, and a reference to article 21 had therefore been included in paragraph (2) of that provision.

112. In response to a question raised regarding paragraph (1) (b), it was pointed out that an exception to exclusivity of jurisdiction of the chosen court so as to permit issuance by other courts of provisional measures reflected an approach found in other multilateral conventions, including the Hamburg Rules.

113. The Working Group noted that paragraph (2) contained a provision on lis pendens, concerning the deference of courts when an action was pending in courts of other contracting States.

114. A suggestion of a drafting nature was to refer to the "court first seized" at the end of paragraph (2).

## Article 25. Determination of court jurisdiction

115. The concern was expressed that the existing formulation would leave a gap in cases in which the undertaking was not issued in a contracting State. Support was expressed for the retention of the text deferring to existing rules on jurisdiction in contracting States or to arbitration under article 24.

## New Article 25 bis. Recognition and enforcement

116. The Working Group considered the following proposal for an additional provision with the above title, to be inserted before the existing article 25 bis:

"Recognition and enforcement of any decision given by a court with jurisdiction in accordance with article 24 or 25 that is no longer subject to ordinary forms of review may be sought in any contracting State unless:

(a) Recognition and enforcement would be contrary to public policy of that State;

(b) The decision was given in default of appearance and the defendant was not duly served with the document which instituted the proceedings or with an equivalent document in sufficient time to enable him to arrange for his defence;

(c) The decision is irreconcilable with a decision given in that State in a dispute between the same parties; or

(d) The decision is irreconcilable with an earlier decision given in another State involving the same cause of action and between the same parties, provided that the earlier decision fulfils the conditions necessary for its recognition and enforcement in the State where recognition and enforcement of the later decision is being sought."

117. No comments were made as to the above provision, beyond the clarification that it would apply to the enforcement of provisional measures.

Article 25 bis. Relationship to other treaty arrangements

118. It was observed that uncertainty might result as regards the interface of the current provision with similar provisions in international agreements such as the 1968 Brussels Convention and the 1988 Lugano Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters. It was suggested that the matter might be stipulated clearly by parties that wish to give primacy to those Conventions, since otherwise the present draft Convention could be considered a specialized convention of the type to which those Conventions would otherwise defer.

119. Upon completion of its review of the proposed text for the articles of a chapter on jurisdiction, opinion continued to be divided as to whether to retain the chapter. The Working Group decided in that light to forgo retention of the chapter.

Consideration of draft articles submitted by the drafting group

Article 7. Issuance, form and irrevocability of undertaking

120. The Working Group agreed to a reformulation of paragraph (2) that would focus more on the undertaking than the present text, which spoke in terms of the demand for payment as a result of the departure from the use of the term "effectiveness". A formulation along the lines of "from the time of issuance of an undertaking, a demand for payment may be made in accordance with the terms and

conditions of the undertaking, unless the undertaking stipulates a different time" was accepted and referred to the drafting group.

121. On paragraph (3), the Working Group agreed to move the words "upon issuance" to follow the word "irrevocable", on the basis that the current formulation could be taken to mean that, once issued, an undertaking could not later be amended to make it revocable.

Article 8. Amendment

122. A proposal was made for the deletion of subparagraph (2) (b), the effect of which modification would be to provide that any amendment would only be valid if consented to or previously authorized by the beneficiary. In support of the proposal, it was stated that the current formulation allowed for unilateral amendments by the guarantor/issuer regarding validity of the extension period and that the text also set rules regarding the form of the amendment and consent which were matters that were better left to prevailing practice. It was pointed out that, in practice, various forms of consent were recognized, including consent manifested by action. The Working Group was therefore urged to limit paragraph (2) to a statement that consent was required.

123. The Working Group was reluctant, however, to change its earlier decision that amendments solely extending the validity period did not need the specific consent of the beneficiary and also its decision to maintain the form requirements in the article (see paras. 20 and 23). At the same time, the Working Group expressed a preference for the earlier formulation of subparagraph (2) (b), which referred to an amendment "consisting solely of an extension of the validity period of the undertaking". It was felt that the proposed words "on its face" might encompass situations where the amendment would seem not to extend the validity period but have the effect in substance of extending the period.

124. It was pointed out that differences with regard to stand-by letters of credit practice would be accommodated since parties were free under the draft Convention to incorporate the Uniform Customs and Practice for Documentary Credits (UCP), which provided a consent requirement for all amendments, without specifying a particular form requirement for the consent.

Article 10. Cessation of right to demand payment

125. As was the case with regard to article 7 (2) (see para. 120), it was suggested that the drafting group should attempt to find a formulation also for article 10 that focused more on the undertaking rather than on demand for payment.

Article 16. Examination of demand and accompanying documents

126. With regard to paragraph (2), the Working Group agreed to move the second reference, "unless otherwise stipulated in the undertaking", with the added words "or elsewhere agreed", to the beginning of the second sentence so as to make it clear that such stipulations would also apply to the means of transmission.

Article 19. [Obligation not to make payment]

127. It was noted that paragraph (1) of article 19 had been reformulated to reflect the decision of the Working Group to avoid the use of the term "improper demand" (see para. 77). At the same time, paragraph (1) was placed in square brackets because there remained outstanding issues to be discussed concerning the proposed approach, which involved the integration of paragraph 17 (2) into article 19.

128. In that regard, a number of concerns were raised regarding the new formulation of paragraph (1), in particular the last phrase in the paragraph, whose import was that the obligation not to make payment was not applicable if the principal/applicant refused to indemnify the guarantor/issuer or to obtain the determination of a court or arbitral tribunal regarding the non-payment. One concern was that such a proviso would have the effect of giving the guarantor/issuer the option to make payment even in cases where the demand was manifestly and clearly improper and therefore payment would be in bad faith. It was said that this would run counter to the obligation of the guarantor/issuer to act in good faith in accordance with article 13 of the draft Convention. It was also pointed out that some of the words in the proviso such as "to obtain the determination of a court" were not clear as to what exactly was expected of the principal/applicant. The suggestion was made that the principle of the proviso could simply be that any principal/applicant who sought non-payment for fraud would be deemed to have agreed to indemnify the guarantor/issuer for the consequences of the non-payment.

129. In response, it was stated that the intention of the proviso was to ensure that judicial determination would be sought and that the guarantor/issuer would be indemnified for any consequences of a non-payment on the basis that the demand was manifestly and clearly improper and payment would be in bad faith. The Working Group agreed that the principle of good faith was fundamental to the draft Convention and that the proviso needed to be reformulated so as to make clear the obligation of the guarantor/issuer not to make any payments that would, in essence, be in bad faith. It was pointed out that the proviso was also not clear as to cases in which the principal/applicant requested the non-payment on the basis that the demand was improper. Such a request, it was pointed out, was a typical element in the majority of cases in practice, and it was therefore desirable to make it clear that, in those cases, the principal/applicant had an obligation to indemnify the beneficiary.

130. After deliberation, the Working Group requested the drafting group to prepare a formulation maintaining the obligation of the guarantor/issuer not to make payment in cases of a manifestly and clearly improper demand where payment would therefore be in bad faith, while also providing the guarantor/issuer with the right to be indemnified for any consequences of non-payment or to request the principal/applicant to take steps to obtain a judicial or arbitral determination to the effect that non-payment was justified.

## FUTURE WORK

131. The Working Group took note of the expectation that, at its twenty-eighth session (Vienna, 2-26 May 1995), the Commission would devote the first two weeks to consideration of the draft Convention and the remainder of the session to considering the other two legal texts on its agenda, including the draft UNCITRAL Model Law on Electronic Data Interchange, and the draft practice notes on preparation of arbitral proceedings, as well as other business.

Notes

1/ Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), para. 18.

2/ Ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.

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Annex

Articles of draft Convention on Independent Guarantees and Stand-by Letters of Credit as revised at the twenty-second and twenty-third sessions*

## CHAPTER I. SCOPE OF APPLICATION

### Article 1. Scope of application

(1) This Convention applies to an international undertaking referred to in article 2:

(a) If the place of business of the guarantor/issuer at which the undertaking is issued is in a Contracting State, or

(b) If the rules of private international law lead to the application of the law of a Contracting State,

unless the undertaking excludes the application of the Convention.

(2) This Convention applies also to an international letter of credit other than a stand-by letter of credit if it expressly states that it is subject to this Convention.

(3) The provisions of articles 21 and 22 apply to international undertakings as defined in article 2 irrespective of whether or not in any given case the Convention applies pursuant to paragraph (1) of this article.

### Article 2. Undertaking

(1) For the purposes of this Convention, an undertaking is an independent commitment, usually referred to as an independent guarantee or as a stand-by letter of credit, given by a bank or other institution or person ("guarantor/issuer") to pay to the beneficiary a certain or determinable amount upon simple demand or upon presentation of other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment is due because of a default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaken by the principal/applicant or another person.

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* For presentation to the Commission, the articles in the present text have been renumbered, taking into account the deletions and additions made to the text by the Working Group at various stages. Following the draft articles is a chart indicating the correspondence between the present and the former article numbers.

(2) The undertaking may be given:

(a) at the request or on the instruction of the customer ("principal/applicant") of the guarantor/issuer;

(b) on the instruction of another bank, institution or person ("instructing party") that acts at the request of the customer ("principal/applicant") of that instructing party; or

(c) on behalf of the guarantor/issuer itself.

(3) Payment may be stipulated in the undertaking to be made in any form, including:

(a) payment in a specified currency or unit of account;

(b) acceptance of a bill of exchange (draft);

(c) payment on a deferred basis;

(d) supply of a specified item of value.

(4) The undertaking may stipulate that the guarantor/issuer itself is the beneficiary when acting in favour of another person.

## Article 3. Independence of undertaking

For the purposes of this Convention, an undertaking is independent where the guarantor/issuer's obligation to the beneficiary is not subject to the existence or validity of an underlying transaction, or to any other undertaking (including stand-by letters of credit or independent guarantees to which confirmations or counter-guarantees relate), or to any term or condition not appearing in the undertaking, or to any future, uncertain act or event except presentation of documents or another such act or event within a guarantor/issuer's sphere of operations.

## Article 4. Internationality of undertaking

(1) An undertaking is international if the places of business, as specified in the undertaking, of any two of the following persons are in different States: guarantor/issuer, beneficiary, principal/applicant, instructing party, confirmer.

(2) For the purposes of the preceding paragraph:

(a) if the undertaking lists more than one place of business for a given person, the relevant place of business is that which has the closest relationship to the undertaking;

(b) if the undertaking does not specify a place of business for a given person but specifies its habitual residence, that residence is relevant for determining the international character of the undertaking.

## CHAPTER II. INTERPRETATION

### Article 5. Principles of interpretation

In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in the international practice of independent guarantees and stand-by letters of credit.

### Article 6. Definitions

For the purposes of this Convention and unless otherwise indicated in a provision of this Convention or required by the context:

(a) "undertaking" includes "counter-guarantee" and "confirmation of an undertaking";

(b) "guarantor/issuer" includes "counter-guarantor" and "confirmer";

(c) "counter-guarantee" means an undertaking given to the guarantor/issuer of another undertaking by its instructing party and providing for payment upon simple demand or upon presentation of other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment under that other undertaking has been demanded from, or made by, the person issuing that other undertaking;

(d) "counter-guarantor" means the person issuing a counter-guarantee;

(e) "confirmation" of an undertaking means an undertaking added to that of the guarantor/issuer, and authorized by the guarantor/issuer, providing the beneficiary with the option of demanding payment from the confirmer instead of from the guarantor/issuer, upon simple demand or upon presentation of other documents, in conformity with the terms and any documentary conditions of the confirmed undertaking, without prejudice to the beneficiary's right to demand payment from the guarantor/issuer;

(f) "confirmer" means the person confirming an undertaking;

(g) "document" means a communication made in a form that provides a complete record thereof.

## CHAPTER III. FORM AND CONTENT OF UNDERTAKING

### Article 7. Issuance, form and irrevocability of undertaking

(1) Issuance of an undertaking occurs when and where the undertaking leaves the sphere of control of the guarantor/issuer concerned.

(2) An undertaking may be issued in any form which preserves a complete record of the text of the undertaking and provides authentication of its source by generally accepted means or by a procedure agreed upon by the guarantor/issuer and the beneficiary.

(3) From the time of issuance of an undertaking, a demand for payment may be made in accordance with the terms and conditions of the undertaking, unless the undertaking stipulates a different time.

(4) An undertaking is irrevocable upon issuance, unless it stipulates that it is revocable.

### Article 8. Amendment

(1) An undertaking may not be amended except in the form stipulated in the undertaking or, failing such stipulation, in a form referred to in paragraph (1) of article 7.

(2) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, an undertaking is amended upon issuance of the amendment if:

(a) The amendment has previously been authorized by the beneficiary; or

(b) If the amendment consists solely of an extension of the validity period of the undertaking;

if any amendment does not fall within subparagraphs (a) and (b) of this paragraph, the undertaking is amended only when the guarantor/issuer receives a notice of acceptance of the amendment by the beneficiary in a form referred to in paragraph (1) of article 7.

(3) An amendment of an undertaking has no effect on the rights and obligations of the principal/applicant (or an instructing party) or of a confirmer of the undertaking unless such person consents to the amendment.

### Article 9. Transfer of beneficiary's right to demand payment

(1) The beneficiary's right to demand payment under the undertaking may be transferred only if so, and to the extent and in the manner, authorized in the undertaking.

(2) If an undertaking is designated as transferable without specifying whether or not the consent of the guarantor/issuer or another authorized person is required for the actual transfer, neither the

guarantor/issuer nor any other authorized person is obliged to effect the transfer except to the extent and in the manner expressly consented to by it.

Article 10. Assignment of proceeds

(1) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, the beneficiary may assign to another person any proceeds to which it may be, or may become, entitled under the undertaking.

(2) If the guarantor/issuer or another person obliged to effect payment has received a notice of the beneficiary in a form referred to in paragraph (1) of article 7 of the beneficiary's irrevocable assignment, payment to the assignee discharges the obligor, to the extent of its payment, from its liability under the undertaking.

Article 11. Cessation of right to demand payment

(1) The right of the beneficiary to demand payment under the undertaking ceases when:

(a) The guarantor/issuer has received a statement of the beneficiary of release from liability in a form referred to in paragraph (1) of article 7;

(b) The beneficiary and the guarantor/issuer have agreed on the termination of the undertaking in a form referred to in paragraph (1) of article 7;

(c) The amount available under the undertaking has been paid, unless the undertaking provides for the automatic renewal or for an automatic increase of the amount available or otherwise provides for continuation of the undertaking;

(d) The validity period of the undertaking expires in accordance with the provisions of article 12.

(2) The undertaking may stipulate, or the guarantor/issuer and the beneficiary may agree elsewhere, that return of the document embodying the undertaking to the guarantor/issuer, or a procedure functionally equivalent to the return of the document in the case of the issuance of the undertaking in non-paper form, is required for the cessation of the right to demand payment, either alone or in conjunction with one of the events referred to in subparagraphs (a) and (b) of paragraph (1) of this article. However, in no case shall retention of any such document by the beneficiary after the right to demand payment ceases in accordance with subparagraphs (c) or (d) of paragraph (1) of this article preserve any rights of the beneficiary under the undertaking.

### Article 12. Expiry

The validity period of the undertaking expires:

(a) at the expiry date, which may be a specified calendar date or the last day of a fixed period of time stipulated in the undertaking, provided that, if the expiry date is not a business day at the place of business of the guarantor/issuer at which the undertaking is issued, or of another person or at another place stipulated in the undertaking for presentation of the demand for payment, expiry occurs on the first business day which follows;

(b) if expiry depends according to the undertaking on the occurrence of an act or event not within the guarantor/issuer's sphere of operations, when the guarantor/issuer receives confirmation that the act or event has occurred by presentation of the document specified for that purpose in the undertaking or, if no such document is specified, of a certification by the beneficiary of the occurrence of the act or event;

(c) if the undertaking does not state an expiry date, or if the act or event on which expiry is stated to depend has not yet been established by presentation of the required document, when six years have elapsed from the date of issuance of the undertaking.

## CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

### Article 13. Determination of rights and obligations

(1) Subject to the provisions of this Convention, the rights and obligations of the guarantor/issuer and the beneficiary are determined by the terms and conditions set forth in the undertaking, including any rules, general conditions or usages specifically referred to therein.

(2) In interpreting terms and conditions of the undertaking and in settling questions that are not addressed by the terms and conditions of the undertaking or by the provisions of this Convention, regard shall be had to generally accepted international rules and usages of independent guarantee or stand-by letter of credit practice.

### Article 14. Standard of conduct and liability of guarantor/issuer

(1) In discharging its obligations under the undertaking and this Convention, the guarantor/issuer shall act in good faith and exercise reasonable care having due regard to generally accepted standards of international practice of independent guarantees or stand-by letters of credit.

(2) A guarantor/issuer may not be exempted from liability for its failure to act in good faith or for any grossly negligent conduct.

## Article 15. Demand

Any demand for payment under the undertaking shall be made in a form referred to in paragraph (1) of article 7 and in conformity with the terms and conditions of the undertaking. In particular, any certification or other document required by the undertaking shall be presented, within the time that a demand for payment may be made to the guarantor/issuer at the place where the undertaking was issued, unless another person or another place has been stipulated in the undertaking. If no certification or other document is required, the beneficiary, when demanding payment, is deemed to impliedly certify that the demand is not in bad faith or otherwise improper.

## Article 16. Examination of demand and accompanying documents

(1) The guarantor/issuer shall examine the demand and any other, accompanying documents in accordance with the standard of conduct referred to in paragraph (1) of article 14. In determining whether documents are in facial conformity with the terms and conditions of the undertaking, and are consistent with one another, the guarantor/issuer shall have due regard to the applicable international standard of independent guarantee or stand-by letter of credit practice.

(2) Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, the guarantor/issuer shall have reasonable time, but not more than seven business days, in which to examine the demand and any other, accompanying documents and to decide whether or not to pay, and if the decision is not to pay, to issue notice thereof to the beneficiary. Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, such notice shall be made by teletransmission or, if that is not possible, by other expeditious means and shall indicate the reason for the decision not to pay.

## Article 17. Payment of demand

(1) Subject to article 19 the guarantor/issuer shall pay against a demand made in accordance with the provisions of article 14. Following a determination that a demand for payment so conforms, payment shall be made promptly, unless the undertaking stipulates payment on a deferred basis, in which case payment shall be made at the stipulated time.

(2) Any payment against a demand that is not in accordance with the provisions of article 14 does not prejudice the rights of the principal/applicant.

## Article 18. Set-off

Unless otherwise stipulated in the undertaking or elsewhere agreed by the guarantor/issuer and the beneficiary, the guarantor/issuer may discharge the payment obligation under the undertaking by availing itself of a right of set-off, except with any claim assigned to it by the principal/applicant.

Article 19. [Obligation not to make payment]

[(1) (a) If, in the view of the guarantor/issuer, it is manifest and clear that:

(i) any document is not genuine or has been falsified;

(ii) no payment is due on the basis asserted in the demand and the supporting documents; or

(iii) judging by the type and purpose of the undertaking, the demand has no conceivable basis,

and for that reason payment would not be in good faith, payment shall not be made to the beneficiary.

(b) In such event, [where the principal/applicant brings to the attention of the guarantor/issuer the presence of one of the elements in subparagraph (a),] the principal/applicant shall [, unless otherwise stipulated in the undertaking or agreed elsewhere by the guarantor/issuer and the beneficiary]:

(i) indemnify the guarantor/issuer against any claim or liability resulting from non-payment, and,

(ii) if requested by the guarantor/issuer, apply for a judicial or arbitral determination that non-payment is justified.]

(2) For the purposes of paragraph (1) (a) (iii) of this article, the following are types of situations in which a demand has no conceivable basis:

(a) The contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialized;

(b) The underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking;

(c) The underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary;

(d) Fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary.

## CHAPTER V. PROVISIONAL COURT MEASURES

Article 20. Provisional court measures

(1) Where, on an application by the principal/applicant or the instructing party, it is shown that there is a high probability that, with regard to a demand made, or expected to be made, by the beneficiary, one of the elements referred to in paragraph (1) of article 19 is present, the court, on the basis of

immediately available strong evidence, may issue a provisional order to the effect that the beneficiary does not receive payment or that the amount of the undertaking held by the guarantor/issuer or the proceeds of the undertaking paid to the beneficiary are blocked, taking into account whether in the absence of such an order the principal/applicant would be likely to suffer serious harm.

(2) The court, when issuing a provisional order referred to in paragraph (1) of this article, may require the person applying therefor to furnish such form of security as the court deems appropriate.

(3) The court may not issue a provisional order of the kind referred to in paragraph (1) of this article based on any objection to payment other than those referred to in paragraph (1)(a)(i), (ii), or (iii) of article 19, or use of the undertaking for a criminal purpose.

## CHAPTER VII. CONFLICT OF LAWS

### Article 21. Choice of applicable law

The undertaking is governed by the law the choice of which is:

(a) Stipulated in the undertaking or demonstrated by the terms and conditions of the undertaking; or

(b) Agreed elsewhere by the guarantor/issuer and the beneficiary.

### Article 22. Determination of applicable law

Failing a choice of law in accordance with article 21, the undertaking is governed by the law of the State where the guarantor/issuer has that place of business at which the undertaking was issued.

Renumbering of articles of draft Convention on Independent Guarantess and Stand-by Letters of Credit

| Article number in renumbered text (annex to present document) | Former article number |
|---|---|
| 1 | 1 |
| 2 | 2 |
| 3 | 3 |
| 4 | 4 |
| 5 | 5 |
| 6(a) | 6(a) |
| 6(b) | 6(a bis) |
| 6(c) | 6(d) |
| 6(d) | 6(e) |
| 6(e) | 6(f) |
| 6(g) | 6(h) |
| 7(1) | 7(new 1) |
| 7(2) | 7(1) |
| 7(3) | 7(2) |
| 7(4) | 7(3) |
| 8 | 8 |
| 9 | 9 |
| 10 | 9 bis |
| 11 | 10 |
| 12 | 11 |
| 13 | 12 |
| 14 | 13 |
| 15 | 14 |
| 16 | 16 |
| 17(1) | 17(1) |
| 17(2) | 17(1 bis) |
| 18 | 20 |
| 19 | 19 |
| 20(1) | 21(1) |
| 20(2) | 20(3) |
| 20(3) | 20(4) |
| 21 | 26 |
| 22 | 27 |

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